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Fall 2015

# Keep Securities Reform Moving: Eliminate the SEC's Integration Doctrine

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### Recommended Citation

Stuart R. Cohn, *Keep Securities Reform Moving: Eliminate the SEC's Integration Doctrine*, 44 Hofstra L. Rev. 3 (2015), available at <http://scholarship.law.ufl.edu/facultypub/745>

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# KEEP SECURITIES REFORM MOVING: ELIMINATE THE SEC’S INTEGRATION DOCTRINE

*Stuart R. Cohn\**

## I. INTRODUCTION TO THE INTEGRATION DOCTRINE

Small businesses are regarded as the engine that drives economic growth.<sup>1</sup> Success generally requires that early stage companies be fed with sufficient infusions of capital often. It is therefore imperative that a national policy of economic growth provide adequate capital-formation opportunities for developing companies. The principal federal statute regulating the offer and sale of securities is the Securities Act of 1933 (“1933 Act” or “Act”).<sup>2</sup> The 1933 Act mandates a formal registration process for all offers and sales of securities unless an exemption from registration exists.<sup>3</sup> Unfortunately, start-ups and developing companies cannot, as a practical matter, raise capital under the expensive, time-consuming process of registration.<sup>4</sup> After having tapped out the founders’ and their families’ resources, the only capital-raising alternative for most companies not blessed with venture capital or angel

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1. See Proclamation No. 9121, 79 Fed. Reg. 27,721 (May 9, 2014) (“Small businesses represent an ideal at the heart of our Nation’s promise—that with ingenuity and hard work, anyone can build a better life. They are also the lifeblood of our economy, employing half of our country’s workforce and creating nearly two out of every three new American jobs.”); SEC. & EXCH. COMM’N, SEC GOVERNMENT-BUSINESS FORUM ON SMALL BUSINESS CAPITAL FORMATION: FINAL REPORT 10 (2006) (“Small businesses pump billions into the economy. They are, in many ways, what makes America great.”).

2. Securities Act of 1933, 15 U.S.C. §§ 77a–77aa (2012).

3. Securities Act of 1933 § 5(a) (“Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly . . . to sell such security through the use or medium of any prospectus or otherwise . . .”). For a discussion of exemptions from the registration mandate, see *infra* Part II.

4. See *infra* note 37 and accompanying text.

financing<sup>5</sup> is to utilize registration exemptions that fit the company's condition and needs.

In light of the desire to foster small business growth, it might be thought that registration exemptions would readily facilitate small business capital financing. That is not the case. Every registration exemption imposes substantial conditions upon a small company's ability to raise capital on an as-needed basis.<sup>6</sup> A growing recognition of the capital-formation problems has led to several statutory and regulatory reforms in recent years.<sup>7</sup> Those reforms, however, have not touched one of the principal impediments to effective financing—namely the so-called “integration doctrine,” a concept created by the Securities and Exchange Commission (“SEC” or “Commission”) that may thwart or invalidate efforts by companies to raise capital through successive securities offerings.<sup>8</sup> This agency-created doctrine is both contrary and anachronistic to reform efforts to ease capital-formation capacities. The reform efforts to date will not bear fruit in the manner intended unless the integration doctrine is eliminated or significantly modified.

The integration doctrine, described more fully below,<sup>9</sup> is raised whenever a company engages in two or more securities offerings within a relatively short time frame—something not at all uncommon among capital-hungry young companies.<sup>10</sup> The doctrine, which contains both safe harbor time frames and an SEC-developed five-factor test,<sup>11</sup> requires that when companies engage in successive offerings, those offerings be examined as a whole to determine whether the separate

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5. Venture capital companies and individual “angel” financiers provide substantial equity financing to small and developing companies. DANIEL H. ARONSON, *VENTURE CAPITAL: A PRACTICAL GUIDEBOOK FOR BUSINESS OWNERS, MANAGERS AND ADVISORS* 11-12 (5th ed. 2011). Only a small fraction of all applicants for venture capital or angel financing are successful in their applications. *Id.* at 15.

6. Conditions vary among exemptions. Among the more significant conditions are the intrastate exemptions under section 3(a)(11) of the 1933 Act and Securities and Exchange Commission (“SEC”) Rule 147, which limit the location of offerees and purchasers and the scope of the issuer's business. Securities Act of 1933 § 3(a)(11); 17 C.F.R. § 230.147 (2014). Rule 504, Rule 505, and Regulation A impose monetary ceilings on the amounts that can be raised. 17 C.F.R. §§ 230.504(b)(2), .505(b)(2), .251(b). Rules 505 and 506(b) impose numerical limitations on the number of investors who are not so-called “accredited investors,” and Rule 506(c) is limited to so-called “accredited investors.” *Id.* §§ 230.505(b)(2)(ii), .506(b)–(c). For a fuller description of the limitations and conditions imposed by the various exemptions, see generally Stuart R. Cohn & Gregory C. Yadley, *Capital Offense: The SEC's Continuing Failure to Address Small Business Financing Concerns*, 4 N.Y.U. J.L. & BUS. 1 (2007).

7. See *infra* notes 45-54 and accompanying text.

8. See *infra* Parts III–IV.

9. See *infra* Part III.

10. See *infra* Part III.A.

11. See *infra* Part III.A.

securities sales can functionally be deemed to be portions of a single offering.<sup>12</sup> If so, the deemed combined offering must meet a single registration exemption, regardless of whether each of the distinct parts was offered and sold in complete accordance with an existing exemption.<sup>13</sup>

The integration doctrine can be illustrated as follows: A young start-up company has tapped out the resources of its owners and friends and needs to raise somewhere between \$1 million and \$1.5 million to keep itself moving forward. A Rule 506(b) private offering arranged through an investment adviser raises \$400,000.<sup>14</sup> Three months later, the company advertises for accredited investors pursuant to the Rule 506(c) exemption and raises \$1 million.<sup>15</sup> The investors in both offerings are given complete information about the company, understand the risks of their investments, and each of the transactions conform to their respective registration exemption requirements, but for the issue of integration. From an investor protection perspective, there should be no policy basis to invalidate either of the offerings. Yet, the SEC, or one of the purchasers who later regrets the investment, can charge that the two offerings should be “integrated” as one, and that the deemed combined offering violates the securities laws. If the charges are successful, which is a likely prospect given the breadth of the integration doctrine,<sup>16</sup> the

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12. See *infra* Part III.A.

13. See *infra* Part III.A. The integration doctrine was described in an SEC release as follows: The integration doctrine provides an analytical framework for determining whether multiple securities transactions should be considered part of the same offering [(integrated)]. This analysis helps to determine whether registration under Section 5 of the Securities Act is required or an exemption [from registration] is available for the entire offering. The integration doctrine, which has existed since 1933, prevents an issuer from improperly avoiding registration by artificially dividing a single offering so that Securities Act exemptions appear to apply to the individual parts where none would be available for the whole.

Integration of Abandoned Offerings, Securities Act Release No. 7943, 74 SEC Docket 571 (Jan. 26, 2001).

14. Rule 506(b) of Regulation D allows a company to raise an unlimited amount of funds, provided that there are no more than thirty-five non-accredited investors who themselves, or through a purchaser representative, have experience and knowledge in making investments in such offerings. 17 C.F.R. § 230.506(b) (2014).

15. Rule 506(c) of Regulation D allows issuers to utilize general advertising and general solicitation for purchasers as long as all purchasers are accredited investors. *Id.* § 230.506(c).

16. Given the relatively short time span between offerings and the fact that the money raised in each offering was for working capital purposes, integration of the offerings under the SEC’s five-factor test is likely. For a description of the five-factor test, see *infra* text accompanying note 63. If combined, the deemed unitary offering will not satisfy Rule 506(b) because the latter offering was publicly advertised (which is prohibited for a Rule 506(b) offering), and will not satisfy Rule 506(c) because there were non-accredited investors in the earlier offering (which is prohibited in a Rule 506(c) offering). See *id.* § 230.506(b)–(c). Nor would any other exemption likely be available.

result may be an SEC or judicial order requiring the company to return all of the offering proceeds to the securities purchasers.<sup>17</sup> What has been gained other than the likely demise of a young company? The answer is nothing, other than adherence to a formalistic doctrine that hampers the capital-raising capacities of small businesses.

Integration would not be a serious problem if issuers could readily fit successive offerings into a single exemption. Unfortunately, registration exemptions are so loaded with technical requirements and conditions that the integration doctrine, when applied, will almost invariably result in the issuer being unable to satisfy any exemption for the deemed unitary offering.<sup>18</sup> An issuer that sold securities under one exemption and is now faced with an unplanned integration problem is highly unlikely to be able to bring a deemed combined offering under the original or any other exemption.<sup>19</sup> Thus, a company that needs to raise capital more than once during a relatively short time period may find either that: (1) it cannot do so under the integration doctrine; or (2) alternatively, the company's distinct offerings are deemed to be one offering which, in the deemed combined form, violates the 1933 Act by failing to meet the requirements of any registration exemption. Neither of these results serves the goal of providing capital-formation opportunities for small businesses. Moreover, the integration doctrine fails to serve the fundamental goal of providing investor protection in the capital-raising process.<sup>20</sup> That basic goal, as well as the goal of promoting capital formation, are now ingrained in the 1933 Act, which Congress amended in 1996 to specifically state that the Commission, in its rule-making process, must "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."<sup>21</sup> If, as will be examined below, each registration exemption contains substantive investor protection requirements,<sup>22</sup> the integration doctrine adds nothing to the achievement of any of the express goals. The doctrine was wrong from its inception, serves no

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17. See Securities Act of 1933 § 12(a), 15 U.S.C. § 77l(a) (2012). Section 12(a)(1) of the 1933 Act provides for rescission, plus interest, for all purchasers to whom the issuer is liable for engaging in a violation of the registration requirement, or damages for those purchasers who no longer own the security. *Id.*

18. See Cohn & Yadley, *supra* note 6, at 15-25.

19. See *infra* text accompanying notes 65-71.

20. For a discussion of the 1933 Act's goal of investor protection, see *infra* text accompanying notes 145-48.

21. Securities Act of 1933 § 2(b). Section 2(b) was added by the National Securities Markets Improvement Act of 1996 (NSMIA), Pub. L. No. 104-290, § 106(a), 110 Stat. 3416, 3424.

22. For a discussion of investor protection elements within the various registration exemptions, see *infra* Part IV.

valid purpose, is a major hindrance to capital formation, and should be eliminated except in the most limited circumstances.

Part II of this Article briefly describes the statutory and regulatory registration exemptions provided by the 1933 Act that allow for capital-raising opportunities by smaller companies.<sup>23</sup> Part III discusses the historical development of the integration doctrine, its initial and later justifications, and representative applications through no-action letters and judicial decisions.<sup>24</sup> Part IV critiques the arguments supporting the doctrine and explores the doctrine's inherent ambiguities and inconsistencies.<sup>25</sup> Part V examines the issue of investor protection with respect to registration exemptions to determine whether the integration doctrine is a necessary adjunct to this fundamental goal of the securities laws.<sup>26</sup> Part VI recommends that the integration doctrine be eliminated in its entirety, except for a limited role with regard to the Rule 504 and Rule 505 numerically based registration exemptions.<sup>27</sup>

## II. CAPITAL RAISING BY SMALL- AND MEDIUM- SIZED COMPANIES

The 1933 Act, President Franklin D. Roosevelt's first piece of New Deal legislation, was a response to the enormous investment losses incurred in the early years of the Great Depression.<sup>28</sup> The 1933 Act mandates a federal scheme of registration for securities offerings, but exempts from such a mandate certain offerings that meet statutory registration exemptions or any future agency-created registration exemptions.<sup>29</sup> The 1933 Act creates two statutory exemptions from registration: (1) the so-called "intrastate exemption," for when the issuer and all offerees and purchasers of securities are residents within the same state;<sup>30</sup> and (2) the so-called "private offering exemption," for

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23. See *infra* Part II.

24. See *infra* Part III.

25. See *infra* Part IV.

26. See *infra* Part V.

27. See *infra* Part VI.

28. LOUIS LOSS, FUNDAMENTALS OF SECURITIES REGULATION 25 (2d ed. 1988) ("When the Crash of 1929, followed by the Great Depression, finally led to the passage of the Securities Act of 1933 during the 'hundred glorious days' of President Roosevelt's New Deal, the first problem was determining what the role of the federal government should be in the protection of investors.").

29. Securities Act of 1933 § 5(a), 15 U.S.C. § 77e(a) (2012). Section 3(b) of the 1933 Act authorizes the addition of other exemptions through administrative adoption. Securities Act of 1933 § 3(b).

30. *Id.* § 3(a)(11) (exempting from registration "[a]ny security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory").

transactions “not involving any public offering.”<sup>31</sup> The Act provides that these statutory exemptions could be augmented by regulatory exemptions adopted where the agency administering the statute determines that registration “is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering.”<sup>32</sup>

The term “public interest” was not defined in the 1933 Act. One universally acknowledged element of public interest was, and remains, the capacity of small companies to raise capital quickly and inexpensively.<sup>33</sup> Capital needs of smaller companies are often sporadic and continual as a result of limited or non-existent revenue streams and uncertain research and development expenses.<sup>34</sup> Working capital is often exhausted rapidly and must be continually supplemented as progress (or lack thereof) demands.<sup>35</sup> The registration process is, unfortunately, extremely expensive, and time- and energy-consuming.<sup>36</sup> Cost, timing, and marketing factors create a far too heavy burden relative to the size and capital needs of small- and medium-sized enterprises.<sup>37</sup> The 1933 Act’s provisions for statutory and administrative registration exemptions reflect the understanding that small and developing companies will necessarily need to raise capital other than through registration.<sup>38</sup>

31. *Id.* § 4(a)(2). This provision was originally section 4(1) of the 1933 Act. It became section 4(2) as a result of certain amendments in 1964, and became section 4(a)(2) as a result of amendments enacted under the Jumpstart Our Business Startups Act of 2012 (“JOBS Act”). *See* Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 201(b)(1), 126 Stat. 306, 314 (2012); Securities Acts Amendments of 1964, Pub. L. No. 88-467, § 12, 78 Stat. 565, 580.

32. Securities Act of 1933 § 3(b)(1). The ceiling for such regulatory exemptions, initially set at \$100,000, has been raised several times and is currently at \$5 million. *Id.* The JOBS Act added section 3(b)(2), authorizing the SEC to adopt rules exempting from registration certain offerings up to \$50 million annually. Jumpstart Our Business Startups Act § 401(a)(2); *see* Securities Act of 1933 § 3(b)(2). Pursuant to such authority, the Commission adopted revised Regulation A exemptions providing a Tier 1 exemption for offerings up to \$20 million and a Tier 2 exemption for offerings up to \$50 million. Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), Securities Act Release No. 9741, Exchange Act Release No. 74,578, Trust Indenture Act Release No. 2501, 80 Fed. Reg. 21,806, 21,807 (Apr. 20, 2015).

33. *See* SEC. & EXCH. COMM’N, *supra* note 1, at 8-9.

34. Cohn & Yadley, *supra* note 6, at 47.

35. The venture capital industry is well acquainted with this phenomenon and has devised elaborate arrangements to account for multiple so-called “down-rounds” of additional investments.

36. *See, e.g.*, PWC, CONSIDERING AN IPO? THE COSTS OF GOING AND BEING PUBLIC MAY SURPRISE YOU I (2012) (“In addition to underwriter fees, on average companies incur \$3.7 million of costs directly attributable to their IPO.”). Companies that engage in a registered offering are required to be public reporting companies for at least one year thereafter, regardless of their size or number of shareholders. Securities Exchange Act of 1934 § 15(d)(1), 15 U.S.C. § 78o(d)(1) (2012). The periodic reporting requirements, which include annual audited financial statements, impose considerable expense upon all reporting companies. PWC, *supra* at 13-14.

37. *See* PWC, *supra* note 36, at 13-14.

38. *See, e.g.*, Manuel F. Cohen, *Federal Legislation Affecting the Public Offering of*

Under its delegated authority, the SEC has created several registration exemptions. The first was Regulation A—a kind of modified registration that requires pre-offering submission of a disclosure document to the SEC for its review and comment.<sup>39</sup> Subsequently, under pressure from the securities bar and the small business community, the SEC adopted several additional registration exemptions: (1) the Rule 147 exemption for intrastate offerings;<sup>40</sup> (2) the Rule 504 exemption for offerings up to \$1 million;<sup>41</sup> (3) the Rule 505 exemption for offerings up to \$5 million;<sup>42</sup> and (4) the Rule 506 exemption for private offerings of unlimited amounts.<sup>43</sup> Meanwhile, Congress also took note of the need for additional registration exemptions, and in 1980, Congress added section 4(5) to the 1933 Act—a self-executing statutory exemption limited to so-called “accredited investors.”<sup>44</sup>

Despite the somewhat broad menu of registration exemptions, small businesses and their advocates continued to press for reform due to the difficult and technical requirements often imposed as conditions to the various exemptions.<sup>45</sup> As a result, there have been several reforms and modifications to the exemptions. Among the reforms, the Commission

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*Securities*, 28 GEO. WASH. L. REV. 119, 148-49 (1959) (“The [exemptions in the 1933 Act] reflect a Congressional determination to temper the full effect of the statute as against offerings by small business concerns . . .”). Manuel Cohen served as Chair of the SEC from 1964 to 1969. *SEC Historical Summary of Chairmen and Commissioners*, U.S. SEC. & EXCHANGE COMMISSION, <https://www.sec.gov/about/sechistoricalsummary.htm> (last visited Oct. 23, 2015).

39. Regulation A consists of SEC Rules 251 through 263. 17 C.F.R. §§ 230.251–263 (2014). In April 2015, Regulation A was amended to provide for two types of Regulation A offerings, Tier 1 for offerings up to \$20 million and Tier 2 for offerings up to \$50 million. Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), Securities Act Release No. 9741, Exchange Act Release No. 74,578, Trust Indenture Act Release No. 2501, 80 Fed. Reg. 21,806, 21,807 (Apr. 20, 2015).

40. 17 C.F.R. § 230.147.

41. *Id.* § 230.504.

42. *Id.* § 230.505.

43. *Id.* § 230.506.

44. Section 4(5) was initially added as section 4(6) through the Small Business Investment Incentive Act of 1980, Pub. L. No. 96-477, § 602, 94 Stat. 2275, 2294. In 2010, Congress later redesignated section 4(6) as section 4(5). Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 944(a), 124 Stat. 1376, 1897-98 (2010). This statutory exemption has proven to be of little importance because it is limited to \$5 million and is not as flexible in terms of amount to be raised or the nature of the purchasers as either Rule 505 or Rule 506. *See Securities Act of 1933* § 4(a)(6), 15 U.S.C. § 77d(a)(5) (2012); §§ 230.505–506.

45. An annual conference between the SEC and representatives of small business interests is mandated by section 503 of the Small Business Investment Incentive Act of 1980. *See* Small Business Investment Incentive Act of 1980 § 503. The report of each conference contains reform recommendations proposed by conference participants. The annual reports can be accessed on the SEC’s website. U.S. SEC. & EXCHANGE COMMISSION, [www.sec.gov/info/smallbusiness/sbforum.htm](http://www.sec.gov/info/smallbusiness/sbforum.htm) (last visited Nov. 22, 2015).



added a “substantial compliance” provision to Regulation D,<sup>46</sup> revised Regulation A to allow for preliminary “testing the waters” solicitations of potential investors prior to filing an offering circular,<sup>47</sup> and eliminated, for Rule 504 offerings, both the prohibition against general advertising and solicitation and the provision that securities sold are restricted securities, provided that such offerings were state registered or sold exclusively under state accredited investor exemptions.<sup>48</sup> Legislative reforms in 1996 preempted state registration laws with respect to so-called “covered securities,” which included offerings under the Rule 506 private offering exemption.<sup>49</sup> Most recently, the Jumpstart Our Business Startups Act of 2012 (“JOBS Act”)<sup>50</sup> took a threefold stab at reform by: (1) creating a so-called “crowdfunding exemption” intended to allow small companies to raise up to \$1 million through internet-based offerings;<sup>51</sup> (2) mandating that the SEC revise its Rule 506 private offering exemption to allow general advertising and solicitation in offerings limited to accredited investors;<sup>52</sup> and (3) directing the SEC to develop a new Regulation A-type exemption for offerings up to \$50 million.<sup>53</sup>

While the various reform measures have eased some of the exemption limitations, the integration doctrine remains untouched and applicable to every exempt offering, therefore continuing to be an

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46. 17 C.F.R. § 230.508 (expressing the result of “[i]nsignificant [d]eviations from a [t]erm, [c]ondition or [r]equirement of Regulation D”).

47. Small Business Initiatives, Securities Act Release No. 6949, Exchange Act Release No. 30,968, Trust Indenture Act Release No. 2287, 51 SEC Docket 2154 (July 30, 1992).

48. Revision of Rule 504 of Regulation D, the “Seed Capital” Exemption, Securities Act Release No. 7644, 69 SEC Docket 364 (Feb. 25, 1999). Rule 502(c) of Regulation D prohibits general advertising and general solicitation in connection with Regulation D offerings, and Rule 502(d) provides that securities obtained in a Regulation D offering “cannot be resold without registration under the Act or an exemption therefrom.” 17 C.F.R. § 230.502(c)–(d).

49. National Securities Markets Improvement Act of 1996, Pub. Law 104-290, § 102, 110 Stat. 3416, 3417-19.

50. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012). The JOBS Act consists of seven titles modifying existing securities law provisions or mandating the SEC to undertake certain reform measures. *Id.* § 2.

51. *Id.* § 302.

52. *Id.* § 201(a)(1). Rule 506(c), allowing general advertising and solicitation in private offerings where the sole purchasers are accredited investors, was adopted in 2013. Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 9415, Exchange Act Release No. 69,959, Investment Advisors Act Release No. 3624, 78 Fed. Reg. 44,771, 44,774-76, 44,778 (July 24, 2013).

53. Jumpstart Our Business Startups Act § 401(a)(2). Pursuant to Congress’s directive, the SEC adopted revisions to Regulation A in 2015. Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), Securities Act Release No. 9741, Exchange Act Release No. 74,578, Trust Indenture Act Release No. 2501, 80 Fed. Reg. 21,806, 21,807 (Apr. 20, 2015).

obstacle to small business financing. The doctrine's perseverance is not due to the SEC's ignorance of its effects. On the contrary, the Commission has expressly acknowledged "the burdens that the integration doctrine place on capital formation."<sup>54</sup> One can appreciate the Commission's concern that registration exemptions should not open the door to securities offerings that may be misused contrary to fundamental policy.<sup>55</sup> However, the Commission's intransigence on the integration doctrine is difficult to understand given the doctrine's lack of clear statutory basis and adverse impact upon the efforts to improve the capital-raising opportunities of small businesses. The recent critique by SEC Commissioner Daniel M. Gallagher, stating that "our focus should be on aligning our exemptions with the ways in which companies raise capital, rather than shoehorning capital-raising techniques into existing, complicated exemptions,"<sup>56</sup> and that "rarely do we remove any of our rules, even after they have long since ceased to serve their purpose or have become obsolete or worse,"<sup>57</sup> is particularly apt to the continuing problems created by the integration doctrine.

### III. THE INTEGRATION DOCTRINE AND ITS DEVELOPMENT

The integration doctrine is far easier to describe than to justify, although description necessarily includes such vague terms as "single plan of financing" and "same general purpose."<sup>58</sup> The doctrine has a heavy bite. It has no good faith, substantial compliance, or advice of counsel defenses. If applied, the doctrine's result is inevitably a violation of the 1933 Act's section 12(a)(1) prohibition against improperly offering or selling unregistered securities.<sup>59</sup> The origin and purported justification for this harsh result, therefore, need careful examination.

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54. Revisions of Limited Offering Exemptions in Regulation D, Securities Act Release No. 8828, Investment Company Act Release No. 27,922, 91 SEC Docket 685 (Aug. 3, 2007).

55. See James D. Cox, *Who Can't Raise Capital?: The Scylla and Charybdis of Capital Formation*, 102 KY. L.J. 849, 849 (2014) ("While the regulatory bodies share the common goal of investor protection, the Securities and Exchange Commission also has among its stated objectives the promotion of capital formation. Thus, it finds itself frequently faced with the conflicting tugs of investor needs and calls for less friction on capital formation and the operation of the securities markets.").

56. Daniel M. Gallagher, Comm'r, Sec. & Exch. Comm'n, *Whatever Happened to Promoting Small Business Capital Formation?* (Sept. 17, 2014), <http://www.sec.gov/News/Speech/Detail/Speech/1370542976550>.

57. *Id.*

58. For reference to these terms in the SEC's five-factor test, see *infra* text accompanying note 63.

59. For remedies provided under section 12(a)(1), see *infra* text accompanying note 70.

### A. Basic Elements and Application

Whenever a company engages in two or more securities offerings, the integration doctrine requires that those offerings be analyzed to determine whether they are in fact distinct or, on the contrary, can be functionally deemed to be two parts of a single offering.<sup>60</sup> If the multiple offerings are deemed to be functionally one offering, that single offering, in its combined form, must satisfy a registration exemption.<sup>61</sup> Analysis is based upon a five-factor integration test developed by the SEC.<sup>62</sup> The five-factor test asks whether the offers and sales effected in the apparently distinct offerings:

- (1) “are part of a single plan of financing;”
- (2) “involve issuance of the same class of securities;”
- (3) “have been made at or about the same time;”
- (4) “involve the same type of consideration being received; and”
- (5) “are made for the same general purpose.”<sup>63</sup>

Application of the five-factor test can be illustrated by the following example: In January, an issuer engages in an intrastate offering exempted under the statutory section 3(a)(11) intrastate offering registration exemption.<sup>64</sup> Five months later, in May, the issuer sells shares to investors in a private offering that satisfies all the elements of the statutory section 4(a)(2) registration exemption.<sup>65</sup> Although each offering satisfies its respective exemption requirements (but for integration), the fact of successive offerings may cause the SEC or any of the purchasers in either of the two offerings to raise the integration doctrine. The January and May offerings would then be examined using the five-factor test to determine whether they can functionally be deemed to be related portions of a single offering. The SEC has never indicated which of the five factors is the most prominent, but no-action letters<sup>66</sup> historically indicate that the principal inquiry would be whether

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60. For the SEC’s description of the integration doctrine, see *supra* note 13.

61. See Darryl B. Deaktor, *Integration of Securities Offerings*, 31 U. FLA. L. REV. 465, 492 (1979).

62. The five-factor test was initially set forth in an SEC Release. Section 3(a)(11) Exemption for Local Offerings, Securities Act Release No. 4434, 1961 WL 61651, at \*1 (Dec. 6, 1961). It has subsequently been repeated in Rule 147 and Rule 502 of Regulation D. 17 C.F.R. §§ 230.147, .502(a) (2014).

63. 17 C.F.R. § 230.502(a).

64. Securities Act of 1933 § 3(a)(11), 15 U.S.C. § 77c(a)(11) (2012).

65. Securities Act of 1933 § 4(a)(2) (providing that the registration requirement of section 5 “shall not apply to . . . transactions by an issuer not involving any public offering”).

66. No-action letters are requests to SEC staff from issuers, usually from their counsel, to consider whether, in the circumstances described in the issuer’s letter, the staff would agree that the SEC should take “no action” if the offering went forward as proposed. *No-Action Letters*, U.S. SEC.

the two offerings were “part of a single plan of financing.”<sup>67</sup> If this vague factor is deemed to exist, the two offerings will be regarded as one, and that unitary offering must satisfy the conditions of a single registration exemption. When the offerings are deemed combined, the result may well be (and usually is) a failure to meet any registration exemption. In this example, if a single investor in the May private offering was not a resident of the issuer’s home state, the combined offerings could not satisfy the section 3(a)(11) intrastate exemption.<sup>68</sup> Likewise, if one or more of the purchasers in the January intrastate offering did not qualify as a “sophisticated” investor for private offering exemption purposes, the combined offering cannot satisfy the private offering exemption.<sup>69</sup> When combined, the offerings will not satisfy any registration exemption, and therefore, both will be in violation of the 1933 Act, despite each of the two offerings’ individual compliance with their respective exemption requirements. For purchasers in either offering, section 12(a)(1) provides for rescission plus statutory interest, or damages if the stock has already been resold at a loss.<sup>70</sup> In an SEC enforcement action, the issuer could be required to return all of the offering proceeds to the investors.<sup>71</sup> Sanctions and remedies are imposed despite adherence by the company to the conditions of each of the two offering exemptions. The integration doctrine has the curious effect, in this instance and others, of inverting the maxim that “two wrongs don’t make a right” into “two rights make a wrong.”

The integration doctrine can be peculiarly perverse when applied to good faith securities sales by young companies. Suppose that founders of a start-up sell some shares to a diverse group of college friends in privately arranged transactions. It is possible, indeed likely, that one or more of these several friends did not meet the “sophistication” standards of the private offering exemption.<sup>72</sup> The friends willingly undertook the

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& EXCHANGE COMMISSION, <http://www.sec.gov/answers/noaction.htm> (last updated Sept. 21, 2012).

67. Deaktor, *supra* note 61, at 529 (“This component [(single plan of financing)] has emerged in many administrative and judicial proceedings . . . as one of the most influential of the traditional integration factors.”).

68. See Securities Act of 1933 § 3(a)(11) (requiring all offerees and purchasers in a section 3(a)(11) offering to be residents of the same state).

69. See *id.* § 4(a)(2). All offerees and purchasers in a section 4(a)(2) offering must meet a “sophistication” requirement. See *infra* text accompanying notes 152-58.

70. Securities Act of 1933 § 12(a).

71. *Id.* § 8A(e) (authorizing the SEC to seek disgorgement from companies that have violated the 1933 Act).

72. Both the section 4(a)(2) and Rule 506(b) private offering exemptions require a degree of purchaser sophistication, although Rule 506(b) expressly permits otherwise unqualified purchasers to utilize so-called “purchaser representatives” who do meet the qualifications. 17 C.F.R.

risk and are not likely to care about compliance with exemption technicalities even if their shares lose value. Several months later the start-up needs a much larger infusion of capital and engages in a carefully structured Rule 506(b) exempt offering. The purchasers this time are sophisticated investors who look upon their investment in a much more cold-hearted manner. If the company's fortunes fail to meet expectations, any one of the later investors could charge the company with a violation of exemption conditions, based not on the Rule 506(b) offering they participated in, but on an alleged integration of the prior and subsequent offerings.<sup>73</sup> The later Rule 506(b) offering will be deemed invalid if combined with the earlier offering to friends who were not qualified purchasers under Rule 506(b). The result would give a right of rescission to all purchasers of the securities, which the later purchasers may well assert if their investment has not met expectations. Any such claims may be devastating to the company, which likely had already spent the funds raised in the offerings and may have insufficient capital to repay the purchasers. The result could be company insolvency, as well as personal liability for the founders who helped sell the securities.<sup>74</sup> One must wonder about the justification for such a potentially dark scenario when contrasted with the need to accommodate the good faith capital-formation efforts by small businesses.

### *B. History and Justification*

During the first year of the 1933 Act, a question arose of whether a company that had filed a registration statement could sell a portion of the proposed registered securities before the registration became effective by utilizing the section 3(a)(11) intrastate registration exemption.<sup>75</sup> Any unsold securities would be offered throughout the country when the registration became effective.<sup>76</sup> At that time the Federal Trade Commission ("FTC") handled securities questions, as the SEC was not created until 1934.<sup>77</sup> The FTC's response to the proposed dual offering process was negative, concluding without further explanation that selling

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§ 230.506(b); see Securities Act of 1933 § 4(a)(2); *infra* notes 156-70 and accompanying text.

73. The statute of limitation for claims based on registration violations is one year after the violation occurred and in no event more than three years after the security was first offered to the public. Securities Act of 1933 § 13.

74. See *supra* text accompanying note 70 for a discussion of section 12(a)(1) remedies.

75. See Securities Act Release No. 97, 1933 WL 28905, at \*5 (Dec. 28, 1933).

76. See *id.*

77. The SEC was formed pursuant to section 4 of the Securities Exchange Act of 1934. Securities Exchange Act of 1934 § 4(a), 15 U.S.C. § 78d(a) (2012).

“part of an issue” under the intrastate exemption and the remainder under a registration statement would be in violation of the Act.<sup>78</sup>

The first adjudication to give content to the integration doctrine was the SEC’s administrative ruling *In the Matter of Unity Gold Corp.*,<sup>79</sup> involving a company that sold 75,000 of its shares in March 1937 to its CEO under a then-existing registration exemption, while concurrently filing a registration statement for the planned sale of 619,000 shares to the public.<sup>80</sup> The SEC charged, and then concluded, that the initial sale to the CEO was “part of the same ‘issue’” as the shares covered by the registration statement.<sup>81</sup> The Commission found it “clear” that the sale to the CEO and the registered offering “involved a single, integrated plan.”<sup>82</sup> When integrated with the planned registered offering, the sale to the CEO came under no exemption and therefore violated the 1933 Act.<sup>83</sup> Thus was born the integration doctrine. The SEC decision did not address the question of why, as in why can an issuer not engage in two or more offerings utilizing different elements of the 1933 Act and its regulations. The response that such offerings are a “single, integrated plan” begged the question as to why the issuer was precluded from relying concurrently on multiple statutory and regulatory provisions. Even assuming a “single, integrated plan” of stock distribution, what statutory or policy justification exists that requires that coordinated stock transactions be completed under a single statutory or regulatory provision?

The SEC’s initial justification for the integration doctrine was set forth in a 1961 SEC Interpretive Release (“1961 Release”) that based application of the doctrine for intrastate offerings on the statutory phrase “part of an issue” found in the section 3(a)(11) exemption.<sup>84</sup> The 1961 Release noted that “[w]hether an offering is ‘part of an issue’ that is,

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78. Securities Act Release No. 97, 1933 WL 28905, at \*5. This was not a true integration question; rather, it was a question of whether the identical securities that were being registered could be simultaneously offered and sold under a registration exemption. Had the issuer wanted to sell, for example, 100,000 shares in the registered offering and concurrently, or within a short time frame, sell an additional 25,000 other shares in an intrastate offering, that would have posed a truer integration question.

79. Securities Act Release No. 530, 1938 WL 34099 (July 19, 1938).

80. *See id.* at \*3, \*5.

81. *Id.* at \*6.

82. *Id.* The two factors noted by the Commission as relevant in determining integration were: (1) the methods of sale and distribution; and (2) the use of the proceeds. *Id.* The Commission’s ruling concluded that “securities of the same class, offered on the same general terms to the public in an uninterrupted program of distribution, cannot be segregated into separate ‘issues’ merely by claiming an exemption for a limited portion of such shares.” *Id.*

83. *See id.*

84. Section 3(a)(11) Exemption for Local Offerings, Securities Act Release No. 4434, 1961 WL 61651, at \*1 (Dec. 6, 1961). *See supra* note 30 for the text of section 3(a)(11).

whether it is an integrated part of an offering previously made or proposed to be made, is a question of fact and depends essentially upon whether the offerings are a related part of a plan or program.”<sup>85</sup> The semantic “part of an issue” reed was thin support for the integration doctrine, particularly as the term is both ambiguous and not used in any other registration exemption. Thus, a broader justification was needed. Less than one year later, the SEC, describing integration in the context of the section 4(2) private offering exemption, simply stated that the question was whether a private offering “should be regarded as a part of a larger offering made or to be made.”<sup>86</sup> Determination would be based on the five-factor test set forth in the 1961 Release.<sup>87</sup>

The Commission altered the integration doctrine in 1974 when it created a time-based “safe harbor” for offerings under its newly adopted Rule 147 intrastate exemption.<sup>88</sup> The integration safe harbor was based on the absence of other offerings during the six months preceding and the six months following the Rule 147 offering.<sup>89</sup> Integration would not be applicable to issuers able to wait out the six months prior to and after a current offering.<sup>90</sup> For offerings less than six months apart, the five-factor test would be applied to determine whether the offerings should be treated as one.<sup>91</sup> The six-month safe harbors were later extended to the Rule 504, Rule 505, and Rule 506 registration exemptions contained in Regulation D, which were adopted in 1982.<sup>92</sup> At the same time, the

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85. Section 3(a)(11) Exemption for Local Offerings, 1961 WL 61651, at \*1.

86. Non-Public Offering Exemption, Securities Act Release No. 4552, 1962 WL 69450, at \*3 (Nov. 6, 1962).

87. *See id.*; *supra* text accompanying note 63.

88. *See* 17 C.F.R. § 230.147(b) (2014); Notice of Adoption of Rule 147 Under the Securities Act of 1933—“Part of an Issue,” “Person Resident,” and “Doing Business Within” for Purposes of Section 3(a)(11) of that Act, Securities Act Release No. 5450, 3 SEC Docket 349 (Jan. 7, 1974).

89. 17 C.F.R. § 230.147(b)(2). The Rule provides as follows:

For purposes of this rule only, an issue shall be deemed not to include offers, offers to sell, offers for sale or sales of securities of the issuer pursuant to the exemption provided by section 3 or section 4(a)(2) of the Act or pursuant to a registration statement filed under the Act, that take place prior to the six month period immediately preceding or after the six month period immediately following any offers, offers for sale or sales pursuant to this rule, *Provided*, That, there are during either of said six month periods no offers, offers for sale or sales of securities by or for the issuer of the same or similar class as those offered, offered for sale or sold pursuant to the rule.

*Id.*

90. *See id.* The six-month periods apply only to offerings outside of those time frames that are made under section 3(b) or section 4(a)(2). *See id.*

91. For a description of the SEC’s five-factor test, see *supra* text accompanying note 63.

92. *See* 17 C.F.R. § 230.502(a). Rule 502(a) contains the safe harbors applicable to Regulation D exemptions under Rules 504, 505, 506(b), and 506(c), and provides:

Offers and sales that are made more than six months before the start of a Regulation D offering or are made more than six months after completion of a Regulation D offering

Commission centered the justification for the integration doctrine on the notion of circumvention, stating that “[t]he integration doctrine prevents an issuer from circumventing the registration requirements . . . by claiming a separate exemption for each part of a series of transactions that constitute a single offering.”<sup>93</sup>

The SEC’s “circumvention” concern has become the predominant justification for the integration doctrine, as reflected in a 2007 SEC Release stating as follows: “While we recognize the burdens that the integration doctrine places on capital formation, improper reliance on exemptions from registration harms investors by depriving them of the benefits of full and fair disclosure and the civil remedies that flow from registration.”<sup>94</sup> The integration doctrine is, thus, intended by the Commission to preserve the primacy of registration as the principal means of offering securities, thereby thwarting efforts by companies to avoid registration by splitting offerings into segmented portions. The SEC’s justification for the doctrine appears to stem from the following line of reasoning: (a) the 1933 Act provides for registration as the principal means of creating investor protection; (b) exemptions from registration do not provide investor protection to the degree provided by registration; and (c) therefore, issuers cannot be allowed to split a single offering into distinct segments as a method to evade registration.<sup>95</sup>

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will not be considered part of that Regulation D offering, so long as during those six month periods there are no offers or sales of securities by or for the issuer that are of the same or a similar class as those offered or sold under Regulation D, other than those offers or sales of securities under an employee benefit plan as defined in Rule 405 under the Act.

17 C.F.R. § 230.502(a).

93. Interpretive Release on Regulation D, Securities Act Release No. 6455, 1983 WL 409415, at \*13-14 (Mar. 3, 1983). Prior to reaching this conclusion, the SEC provided in its interpretative release that “[i]ntegration operates to identify the scope of a particular offering by considering the relationship between multiple transactions. It is premised on the concept that the Securities Act addresses discrete offerings and on the recognition that not every offering is in fact a discrete transaction.” *Id.*

94. Revisions of Limited Offering Exemptions in Regulation D, Securities Act Release No. 8828, Investment Company Act Release No. 27,922, 91 SEC Docket 685 (Aug. 3, 2007).

95. In its most recent comment on the integration doctrine, contained in the March 25, 2015, Release adopting amendments to Regulation A, the Commission asserted that the integration safe harbor provision in Regulation A “has historically provided . . . issuers, particularly smaller issuers whose capital needs often change, with valuable certainty as to the contours of a given offering and their eligibility for an exemption from Securities Act registration.” Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), Securities Act Release No. 9741, Exchange Act Release No. 74,578, Trust Indenture Act Release No. 2501, 80 Fed. Reg. 21,806, 21,818 (Apr. 20, 2015). It is quite probable that many small issuers would be willing to sacrifice the SEC’s purported “valuable certainty” for a standard that allows greater flexibility in raising capital. Indeed, it is appropriate to ask why “certainty” should be the normative doctrine for what even the SEC recognizes as the changing capital needs of small companies. And if certainty is an intended goal, much greater certainty would be achieved by eliminating the integration doctrine



#### IV. CRITIQUE OF THE INTEGRATION DOCTRINE

The integration doctrine has had its share of severe critics, both as to underlying policy and application. After exhaustively reviewing the history of the doctrine and its application, Professor Darryl Deaktor concluded that the SEC's five-factor test "appears insufficiently focused to provide guidance for the structuring of complex financial arrangements," and that the "generality of its language and the existence of substantial overlaps in the factors engender confusion."<sup>96</sup> Professor Rutherford Campbell was more blunt when he referred to the integration doctrine as "one of the most vexing and pointless concepts of the Securities Act of 1933."<sup>97</sup> American Bar Association ("ABA") committees have weighed in more than once attempting to modify the doctrine,<sup>98</sup> and even the SEC's own advisory committee recommended a substantial revision of the doctrine.<sup>99</sup> Despite all, the Commission has appeared oblivious to criticism. Given recent reform efforts, and the continuing adverse impact of the integration doctrine on the capacity to use registration exemptions, it is appropriate to revisit the doctrine to examine its purported justification and the problems associated with its definition and application.

##### A. *The Circumvention Justification*

The SEC's principal justification for the integration doctrine centers on the primacy of the registration process to protect investors and the supposed lessening of such protection when companies engage in

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rather than continuing its ambiguous standards.

96. Deaktor, *supra* note 61, at 541.

97. Rutherford B. Campbell, *The Overwhelming Case for the Elimination of the Integration Doctrine Under the Securities Act of 1933*, 89 KY. L.J. 289, 289 (2000).

98. There have been two attempts by ABA committees to seek modification of the integration provisions. Neither effort reached fruition. See A.B.A. Comm. on Fed. Regulation of Sec., *Integration of Securities Offerings: Report of the Task Force on Integration*, 41 BUS. LAW. 595, 623-24 (1986); A.B.A. Subcomm. on P'ships, Trusts and Unincorporated Ass'ns, *Integration of Partnership Offerings: A Proposal for Identifying a Discrete Offering*, 37 BUS. LAW. 1591, 1610-12 (1982).

99. See Revisions of Limited Offering Exemptions in Regulation D, Securities Act Release No. 8828, Investment Company Act Release No. 27,922, 91 SEC Docket 685 (Aug. 3, 2007). The attendant SEC release provided:

Our Advisory Committee on Smaller Public Companies advised that the six-month safe harbor period from integration provided in Rule 502(a) "represents an unnecessary restriction on companies that may very well be subject to changing financial circumstances, and weighs too heavily in favor of investor protection at the expense of capital formation" . . . . Based on their analysis of the issue, the Advisory Committee recommended that we shorten the integration safe harbor from six months to 30 days.

*Id.*

exempt offerings.<sup>100</sup> The justification's premise, however, may be seriously doubted. While investor protection was unquestionably a major goal of the 1933 Act, nothing in that act suggests that registration must be preferred over exemptions in order to protect investors. The delegated agency authority to create regulatory exemptions specifically allows for exemptions where the registration requirement "is not necessary in the public interest and for the protection of investors."<sup>101</sup> The implicit premise is that registration exemptions will, through their own terms, provide sufficient investor safeguards, even if such safeguards are not equal to those provided by the registration process.<sup>102</sup> Investor protection in exempt transactions was also preserved in the 1933 Act through the explicit application of the section 12(a)(2)<sup>103</sup> and section 17<sup>104</sup> antifraud provisions to registration exemptions.<sup>105</sup> The premise that registration has primacy over exemptions because the former provides superior investor protection is thus not justified by examining the 1933 Act's statutory provisions.

The "circumvention" justification as a protection against registration evasion is also unconvincing. Granted that avoidance of registration might be the motivation in a small number of cases that involve split offerings, it is far more likely that such offerings are by companies that have no thought of evading registration, but simply have a legitimate need for immediate capital. Indeed, for nearly all small and developing companies, registration is not a realistic option.<sup>106</sup> Small businesses do not have the time or resources to undertake a registered offering. The notion that companies might engage in multiple offerings in order to circumvent registration does not comport with reality, as such companies cannot practically engage in a registered offering even if multiple offerings were combined. To put it differently, if a company needs to raise additional capital shortly after having engaged in an exempt offering, its choices are not in fact registration or waiting

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100. See *supra* text accompanying note 95.

101. Securities Act of 1933 § 3(b)(1), 15 U.S.C. § 77c(b)(1) (2012).

102. Among the explicit investor protection elements in a registered offering are the mandated disclosure documents reviewed by the Commission staff and the statutory liability provisions of section 11 applicable to the issuer, directors, signors of the registration statement, underwriters, and experts. Securities Act of 1933 § 11(a).

103. *Id.* § 12(a)(2).

104. *Id.* § 17.

105. *Id.* § 12(a)(2) ("Any person who . . . offers or sells a security (whether or not exempted by the provisions of section 3[]) . . . by means of a prospectus or oral communication, which includes an untrue statement of a material fact . . ."); *id.* § 17 ("The exemptions provided in section 3 shall not apply to the provisions of this section.").

106. See *supra* notes 36-38 and accompanying text for a discussion of costs of a registered offering.

multiple months before starting another offering. The goal is not to break the law, but to raise capital, which realistically can only be accomplished through a registration exemption. Thus, rather than deeming multiple offerings as a means to evade registration—a pejorative conclusion that implies bad motives—it is more appropriate to regard the multiple offerings as a company’s effort to maximize its capital-formation opportunities within the parameters of exemption conditions. In reviewing the Commission’s “evasion” concern, one commentator appropriately noted that the purported justification fails to distinguish good faith capital-raising efforts (which are likely to be much more numerous) from those that are perhaps more suspect.<sup>107</sup> Although this analysis is correct, the commentator’s recommendation that the integration doctrine be revised to focus on whether the company had a legitimate business reason for needing the additional capital<sup>108</sup> carries the unfortunate burden of ambiguity. A legitimate business reason might exist for allowing multiple offerings where unanticipated financial needs arise, but even in such circumstances, one can imagine the SEC or civil litigants arguing as to what is truly unanticipated, with the burden of proof being placed on the issuer to justify the timing, needs, and amounts of its various offerings.

The most serious flaw in the Commission’s justification for the integration doctrine is the notion that the doctrine is a necessary adjunct to the goal of investor protection.<sup>109</sup> The underlying presumption is that registration exemptions do not provide adequate investor protection to potential purchasers. In fact, investor protection elements are contained in the various registration exemptions, as discussed below.<sup>110</sup> It defies logic to conclude that the investor protection elements contained in the various exemptions are vitiated in an offering that fully complies with all exemption conditions when the issuer subsequently sells additional securities under another exemption that also fully complies with the exemption conditions for that offering. Suffice it to say that, at this point, the presumption of inadequate protection is a faulty one and belies the Commission’s own efforts to create investor safeguards within each of the various exemptions.

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107. Cheryl L. Wade, *The Integration of Securities Offerings: A Proposed Formula That Fosters the Policies of Securities Regulation*, 25 LOY. U. CHI. L.J. 199, 228-29 (1994).

108. *Id.* at 238.

109. *See supra* text accompanying note 95.

110. *See infra* Part V.

## B. Inherent Ambiguities and Inconsistencies

### 1. The Five-Factor Test

There are no bright-line tests to determine answers to any integration question under the SEC's five-factor test. Nor has the Commission provided guidance as to the meaning or relative weights of the various factors.<sup>111</sup> The ambiguities and uncertainties inherent in the test have been so thoroughly criticized that additional critique is superfluous.<sup>112</sup> The ambiguities of the five elements essentially come down to an "eye of the beholder" determination. If a company raises \$200,000 in March and the growth of the company requires raising an additional \$300,000 in July, is that part of a "single plan of financing"? Even if the company had a business plan that called for raising \$200,000 in March and then, depending on the progress of the company, raising an additional \$300,000 several months later if needed, is that contingency planning a "single plan of financing"? If a small start-up raises \$700,000 to finance equipment and four months later raises \$500,000 to open a marketing office, does the fact that the entire \$1,200,000 is employed to get the business off the ground mean that the offerings are for the "same general purpose"? There are no bright-line standards to answer these questions, yet the standards impose themselves upon every company that raises capital through more than a single offering. Those companies and their counsel may well agree with the conclusion by one commentator that the five-factor test has launched "more than [forty] years of ambiguity, confusion and contradiction."<sup>113</sup>

If issuers and their counsel are unable to determine whether discrete offerings will be combined under the integration doctrine, it is little comfort to advise a company that it can request a no-action letter from

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111. Theodore W. Jones, *The Doctrine of Securities Act "Integration,"* 29 SEC. REG. L.J. 320, 325 n.24 (2001) ("Unfortunately, the Commission has never indicated which factors carry the most weight or just how many of these factors must be analyzed to suggest the absence of a relationship between offerings in order for an issuer to avoid integration. As such, any analysis under the five factors test involves inherent uncertainty.").

112. See, e.g., THOMAS LEE HAZEN, *THE LAW OF SECURITIES REGULATION* 237 (6th ed. 2009) ("The Commission has not provided any significant guidance as to how these [five factors] should be weighted . . . . The . . . guidelines . . . do not provide much certainty in planning exemptions."); LOUIS LOSS & JOEL SELIGMAN, *FUNDAMENTALS OF SECURITIES REGULATION* 360 (4th ed. 2004) (stating that the "multifactor test may fairly be criticized as . . . indeterminate"); Perry E. Wallace, Jr., *Integration of Securities Offerings: Obstacles to Capital Formation Remain for Small Businesses*, 45 WASH. & LEE L. REV. 935, 989 (1988) ("The integration doctrine continues to frustrate issuers engaged in the capital formation process, engulfing them in a sea of ambiguity, uncertainty, and potential liability.").

113. Jerald Cliff McKinney, II, *Factoring the Ambiguity: A Futile Attempt to Understand the Ambiguous Nature of the Integration Doctrine's Five-Factor Test*, 31 SEC. REG. L.J. 337, 337 (2003).

SEC staff.<sup>114</sup> For one, that is asking the company to go into the mouth of the tiger that invented, and is committed to, the doctrine. If the question boils down to the “single plan of financing” factor, which is often the most prevalent question, there is a dearth of practical guidance and the SEC’s application of this factor through no-action letter requests has, at best, “lacked consistency.”<sup>115</sup> Moreover, SEC staff does not necessarily view capital-raising efforts in the same business-oriented light as issuers. Thus, for example, an issuer that distinguished an initial offering as “seed capital” from an offering two months later that it regarded as “long-term financing” was denied no-action relief.<sup>116</sup> Another issuer who had a common stock offering followed by a convertible debenture offering was likewise denied a no-action letter because the debentures were convertible into common stock, and the SEC staff conflated the two securities regardless of their differing financial elements or the timing or likelihood of any eventual conversion.<sup>117</sup> Even if an issuer receives a favorable no-action letter, there is the ever-present risk that the letter cannot be relied upon if there are any deviations from the described offering process—a precarious condition given the exigencies of particular financing needs and investor demands.<sup>118</sup>

Recent Commission statements have been equally obtuse in defining the parameters of the integration doctrine. In its March 2015 Release adopting revised Regulation A, the Commission stated: “[W]e believe that an offering made in reliance on Regulation A should not be integrated with another exempt offering made by the issuer, provided that each offering complies with the requirements of the exemption that is being relied upon for the particular offering.”<sup>119</sup> At first glance, this statement looks like an acceptance of the sensible notion that

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114. See *supra* note 66. A no-action request details the issuer’s proposed offering and sets forth the issuer’s basis for concluding that the proposed conduct is permissible within a particular exemption or other statutory or regulatory requirement. *No-Action Letters*, *supra* note 66.

115. Deaktor, *supra* note 61, at 529; see also Daniel J. Morrissey, *Integration of Securities Offerings—The ABA’s “Indiscreet” Proposal*, SEC. L. REV., 1985, at 165 (“The letters are often difficult to harmonize even when they deal with analogous situations.”).

116. LaserFax, Inc., SEC No-Action Letter [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,136 (Sept. 16, 1985).

117. State St. Mortg. Co., SEC No-Action Letter [1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,415 (Mar. 12, 1987); see also LaserFax, Inc. [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 78,136.

118. It should also be noted that no-action letters are staff opinions, not binding on the Commission. See *No-Action Letters*, *supra* note 66. Although an SEC enforcement action would be highly unlikely after a no-action letter has been granted, any slight deviation from the terms of the proposed offering could result in the negation of the staff opinion. See *id.*

119. Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), Securities Act Release No. 9741, Exchange Act Release No. 74,578, Trust Indenture Act Release No. 2501, 80 Fed. Reg. 21,806, 21,819 (Apr. 20, 2015).

independent exemptions will not be integrated, provided that each meets its own exemption terms. That does not appear to be the case. The statement is qualified by two examples of exempt offerings made concurrently with a Regulation A offering, with both examples being highly unlikely to occur.<sup>120</sup> Moreover, the examples referencing “concurrent” offerings are problematic. When are two offerings in fact “concurrent” for integration purposes? The Regulation A integration provisions clearly apply the integration doctrine for most exempt offerings made within six months following a Regulation A offering.<sup>121</sup> If the non-Regulation A offering ends prior to the Regulation A offering, Regulation A already provides for no integration of those offerings.<sup>122</sup> If the non-Regulation A offering ends subsequent to the Regulation A offering, the five-factor integration test will apply to offers and sales after the Regulation A offering ended.<sup>123</sup> The Commission’s statement affirming the validity of independent exempt offerings does not add any new element to the integration equation. Given the risks and ambiguities inherent in the integration doctrine, it will be the rare counsel or company that advises or chooses to undertake an otherwise exempt offering concurrent with Regulation A.

Courts seem a bit more understanding of, and responsive to, the plight of small businesses, although little practical guidance can be gleaned from the relatively few reported cases.<sup>124</sup> Courts have denied plaintiff summary judgment motions on the grounds that the ambiguities

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120. *See id.* One example is an offering for which general solicitation is not permitted, such as a Rule 506(b) offering, being made concurrently with a Regulation A offering that has “tested the waters” through general solicitation of potential investors. *Id.* The second example is an offering that allows general solicitation, such as Rule 506(c), in which the offering also advertises the concurrent Regulation A offering. *Id.* The first example would fail the integration test if any of the Rule 506(b) offerees were solicited through the Regulation A “testing the waters” process. The second example would fail the integration test, per the SEC, if the Rule 506(c) materials did not provide sufficient Regulation A disclosures. Both examples are unusual insofar as it would be highly unlikely for a company to be raising money through concurrent Regulation A and private offerings, especially given the increased ceilings of \$20 million (Tier 1) and \$50 million (Tier 2) for Regulation A offerings and the marketing advantages of Regulation A offerings relative to private offerings. *Id.* at 21,807.

121. SEC Rule 251(c)(2) has an exclusive list of post-Regulation A offerings that are not subject to the integration test. *See* 17 C.F.R. § 230.251(c)(2) (2014). The only exempt offerings within that list are stock sales made pursuant to employee benefit plans, foreign transactions under Regulation S, and sales under the crowdfunding exemption of section 4(a)(6). *Id.* The exemption for sales under the crowdfunding exemption is a recent addition to Rule 251(c)(2). 80 Fed. Reg. at 21,895.

122. *See* 17 C.F.R. § 230.251(c)(1).

123. 80 Fed. Reg. at 21,895.

124. *See, e.g.,* ABA Subcomm. on P’ships, Trusts and Unincorporated Ass’ns, *supra* note 98, at 1597 (“[V]ery few cases have provided an analysis that is instructive to counsel involved in securities offerings that present such issues.”).

within the integration doctrine required more extensive findings of fact.<sup>125</sup> In a case in which the issuer had engaged in six offerings within a two-and-a-half-year period, the District Court of Massachusetts expressed a clear sympathy for the issuer's plight in not being able to obtain adequate financing and that "each successive financing was expected by the defendants to be the last."<sup>126</sup> The Southern District of New York court expressed a similar recognition of the financing problems facing small companies when it denied application of the integration doctrine where "unforeseen operating difficulties" required the issuer to undertake multiple offerings.<sup>127</sup>

SEC enforcement actions and cases that have applied the integration doctrine are not numerous, yet the relative paucity of such actions does not render the doctrine benign for lack of force. There are cogent reasons for the lack of reported cases. Investors who might have integration-based claims may be satisfied with their economic return and, thus, would not desire to pursue a rescission remedy. For those investors who do make claims, the matters might be privately settled through buyouts or other economic arrangements. Despite the lack of reported violations, the integration doctrine's bite is ever-present and significant. Companies aware of the doctrine or represented by counsel astute in securities laws may receive negative, or at best cautionary,

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125. See, e.g., *SEC v. Alternate Energy Holdings, Inc.*, No. 10-CV-00621, 2013 WL 1000329, at \*4 (D. Ida. Mar. 13, 2013); *In re Veritas Fin. Corp.*, No. 05-10774, 2007 WL 2293009, at \*1, \*5 (Bankr. S.D.N.Y. Aug. 10, 2007).

126. *Livens v. William D. Witter, Inc.*, 374 F. Supp. 1104, 1106-07 (D. Mass. 1974). The district court in *Livens v. William D. Witter, Inc.*, stated:

In the instant case, some basis for integration appears in the facts that (a) for the most part the offerings were made for the same general purpose, and (b) the parties recognized that the first financing in October, 1967 might be inadequate and additional financing might be required. On the other hand, everyone hoped and expected that the initial \$630,000 would be sufficient to enable LPC [(a now bankrupt company for which the defendants sold unregistered securities)] to operate profitably. It was felt that deposits by tourists reserving places on package tours sponsored by LPC, known as the "customer deposit float," would supplement its working capital sufficiently to enable it to prosper. Thereafter, each successive financing was expected by the defendants to be the last which would be required to make LPC self-supporting. A series of obstacles to profitability was encountered, many of them beyond the control of the company or the defendants who, incidentally, each invested \$1,400,000 of their own funds. Specific acquisitions of subsidiaries and the charter of a cruise ship, MTS Orpheus, were not contemplated at the time of the first financing in October, 1967. The evidence simply did not show a single plan of financing. Moreover, the several offerings were not made at or about the same time, different classes of securities were issued and the prices of the securities varied. On balance, the integrated offering doctrine is clearly inapplicable.

*Id.* at 1107.

127. *Barrett v. Triangle Mining Corp.*, No. 72-CV-5111, 1976 WL 760, at \*6 (S.D.N.Y. Feb. 2, 1976).

advice as to whether planned offerings may go forward. Indecision could result in not moving forward with needed financing or, perhaps, altering plans in order to attempt to avoid integration's application, such as offering a different class of securities than what was optimally considered.<sup>128</sup> Lurking behind the integration doctrine is not only the potentiality of rescission actions against the company, but also personal liability of the company officers who participated in the offering process.<sup>129</sup> Other less obvious problems could exist. Companies that undertake registered or Regulation A offerings are required to disclose prior offerings to the SEC.<sup>130</sup> The Commission may take a hard, and potentially unhappy, look at the company's history, as occurred in the *Unity Gold* case,<sup>131</sup> and determine that prior securities offerings were invalid on account of the integration doctrine.<sup>132</sup> Quite apart from the doctrine's effect upon additional securities offerings, companies with integration problems based on past offerings may need to disclose contingent liabilities in their financial statements given to lenders or other third parties.

## 2. The Six-Month Safe Harbors

The six-month safe harbors applicable to Rule 147, Regulation A, and Regulation D exemptions<sup>133</sup> have the virtue of creating a clear cut-off for the integration doctrine. However, the safe harbors are not a panacea, especially for small and developing companies. Six months is an arbitrary time frame that, for many smaller companies, may be too long a period to wait before safely raising additional capital. In 2006, the SEC's own advisory committee recognized this problem when it recommended reducing the safe harbors to thirty days, a

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128. See, e.g., Deaktor, *supra* note 61, at 473-74 (“[A]n issuer uncertain of the applicability of integration to a proposed offering may be forced to forego the proposed offering altogether or to adjust its characteristics significantly to avoid a potential violation of the registration requirements. Either course of action may entail considerable hardship for the issuer.”).

129. Defendants in section 12(a)(1) actions may include individuals who solicited purchasers on behalf of the issuer. See *Pinter v. Dahl*, 486 U.S. 622, 629-30 (1988) (remanding the case to lower courts to determine whether purchaser of securities in private offering who solicited others to purchase was soliciting on behalf of the issuer rather than giving gratuitous advice).

130. See 17 C.F.R. §§ 229.701, 239.90 (2014). Item 701 of Regulation S-K, which sets forth disclosure requirements for registered offerings, requires issuers to detail all unregistered sales of securities in the prior three years. 17 C.F.R. § 229.701. Item 6 of Part I of Form 1-A used in a Regulation A offering requires disclosure of all unregistered securities issued or sold during the prior year. 17 C.F.R. § 239.90 (2014).

131. See *supra* text accompanying notes 79-83.

132. *Unity Gold Corporation*, Securities Act Release No. 530, 1938 WL 34099, at \*6 (July 19, 1938).

133. For a description of the integration doctrine's six-month safe harbors, see *supra* text accompanying notes 88-93.



recommendation that would have effectively eliminated the integration doctrine.<sup>134</sup> While regarding thirty days as too short a time frame, the Commission was sensitive to the fact that six months may be too long a period in some circumstances and, therefore, in response to the Advisory Committee, proposed reducing the integration safe harbor period to ninety days.<sup>135</sup> Inexplicably, and without comment, this proposal was never adopted. The six-month periods remain, although equally inexplicably, the safe harbors do not apply to all exemptions. The intrastate section 3(a)(11) statutory exemption and the private offering section 4(a)(2) statutory exemption do not benefit from the regulatory safe harbors. Offerings under those statutory exemptions continue to be saddled with timing and criteria uncertainties. Indeed, strict interpretation of the regulatory safe harbors could lead to the rather absurd result that a section 4(a)(2) offering in January might be integrated with a Rule 506 offering in September, but the Rule 506 offering would have the protection against integration afforded by its six-month safe harbor.<sup>136</sup>

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134. FINAL REPORT OF THE ADVISORY COMMITTEE ON SMALLER PUBLIC COMPANIES TO THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION 94-96 (2006), <http://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf>.

135. Revisions of Limited Offering Exemptions in Regulation D, Securities Act Release No. 8828, 91 SEC Docket 685 (Aug. 3, 2007). The Commission's report noted:

The current six-month time frame of the safe harbor in Rule 502(a) provides a substantial time period that has worked well to clearly differentiate two similar offerings and provide time for the market to assimilate the effects of the prior offering. The Advisory Committee has expressed concern, however, that such a long delay could inhibit companies, particularly smaller companies, from meeting their capital needs. We recognize that increased volatility in the capital markets and advances in information technology have changed the landscape of private offerings. We remain concerned, however, that an inappropriately short time frame could allow issuers to undertake serial Rule 506-exempt offerings each month to up to 35 non-accredited investors in reliance on the safe harbor, resulting in unregistered sales to hundreds of non-accredited investors in a year. Such sales could result in large numbers of non-accredited investors failing to receive the protections of Securities Act registration. Our proposal seeks to strike an appropriate balance between the number of non-accredited investors allowed in an offering relying on the integration safe harbor and the non-public nature of that offering. It would be an anomalous result that an issuer could make an offering to hundreds of non-accredited investors in reliance on the integration safe harbor, triggering reporting requirements under the Exchange Act, without a public offering. We propose, therefore, to lower the safe harbor time frame to 90 days rather than the 30 days recommended by the Advisory Committee. We believe 90 days is appropriate, as it would permit an issuer to rely on the safe harbor once every fiscal quarter.

*Id.*

136. This rather odd result is due to the apparent "one-way" integration provision of Rule 502(a) of Regulation D. 17 C.F.R. § 230.502(a) (2014) ("Offers and sales that are made more than six months before the start of a Regulation D offering or are made more than six months after completion of a Regulation D offering will not be considered part of that Regulation D offering . . ."). Among other inconsistencies in the integration doctrine is the broader "two-way"

Variations among time frames are not the only inconsistencies within the integration doctrine. If the SEC is concerned about circumvention of registration requirements, why did it eliminate integration with regard to any offering that precedes a Regulation A offering regardless of timing or amount?<sup>137</sup> And having eliminated the integration doctrine for offerings that precede a Regulation A offering, why did the SEC impose the doctrine upon post-Regulation A offerings?<sup>138</sup> Why does integration specifically apply to Rule 504 offerings up to \$1 million, yet the SEC has eliminated integration for the so-called “crowdfunding exemption,” which also exempts up to \$1 million of capital raised?<sup>139</sup> If companies engage in “bridge financing” to raise capital prior to a forthcoming registered initial public offering (“IPO”),<sup>140</sup> why does SEC Rule 152 eliminate integration for section 4(a)(2) and Rule 506 private offerings that precede a registered offering but retain the integration doctrine for bridge financing effected under Rule 504, Rule 505, or the intrastate registration exemptions?<sup>141</sup> Similarly, why does Rule 155 create an integration safe harbor (and after only thirty days, not six months) for withdrawn registration statements followed by private offerings but not for any other exempt offerings following a withdrawn registration?<sup>142</sup>

Inconsistencies within the integration doctrine are inexplicable and lead to illogical results and mistakes in planning securities offerings.

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provision in Rule 251(c) of Regulation A. *Id.* § 230.251(c).

137. *Id.* § 230.251(c)(1).

138. Rule 251(c)(2) contains a limited list of post-Regulation A offerings that are not subject to integration with the Regulation A and includes a six-month safe harbor similar to Regulation D. *Id.* § 230.251(c)(2).

139. *See* Crowdfunding, Securities Act Release No. 9974, Exchange Act Release No. 76,324, 80 Fed. Reg. 71,388, 71,499 (Nov. 16, 2015) (adopting an amendment specifying no integration in crowdfunding exemptions with any other securities offering).

140. “Bridge financing” refers to the period just prior to a public offering during which the company needs capital to finance the interim period and the public offering expenses. *Bridge Financing*, BUSINESSFINANCE.COM (June 19, 2007), <http://www.businessfinance.com/articles/bridge-financing.htm>.

141. 17 C.F.R. § 230.152. In a similar vein, Rule 255(e) of Regulation A, which applies to a Regulation A offering that is abandoned in favor of a registered offering, creates an integration distinction depending on whether during the Regulation A offering the issuer had solicited only qualified institutional buyers and accredited investors, or whether there had been solicitation of the lesser masses. Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), Securities Act Release No. 9741, Exchange Act Release No. 74,578, Trust Indenture Act Release No. 2501, 80 Fed. Reg. 21,806, 21,899 (Apr. 20, 2015). In the latter case, the issuer must wait at least thirty calendar days between the last solicitation and the filing of the registration statement. *Id.* There is no compelling evidence that such a thirty-day waiting period provides needed investor protection given the technical requirements and intended safeguards of a registered offering.

142. *See* 17 C.F.R. § 230.155.

Companies might learn too late that the integration impediment could have been avoided by use of a different exemption in earlier offerings. For example, suppose a company raised \$4 million in a Regulation A offering and three months later needs an additional \$2 million for current operational expenses. The integration doctrine is likely to invalidate any short-term subsequent offering as well as the initial Regulation A offering.<sup>143</sup> However, had the company's initial offering of \$4 million been made under Rule 505 or Rule 506 of Regulation D, a later Regulation A offering would not be integrated with the earlier offering, and the financing could be achieved without integration risk.<sup>144</sup> Reason defies logic for such a result.

#### V. IS THE INTEGRATION DOCTRINE NECESSARY FOR INVESTOR PROTECTION?

Investor protection is the undisputed primary goal of securities laws.<sup>145</sup> That is what motivated the enactment of the 1933 Act following the enormous investor losses incurred prior to and during the Great Depression.<sup>146</sup> Investor protection was sought to be achieved through a variety of means, including agency review of registration statements prior to any public offering, specific standards for disclosure in registration statements, agency rulemaking authority, the continued application of state securities laws,<sup>147</sup> and specific provisions for civil, administrative, and criminal sanctions applicable to registered and exempt offerings in the event of disclosure violations.<sup>148</sup>

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143. Regulation A will be subject to integration under the five-factor test for any subsequent offers within six months except registered offerings and foreign offerings under Regulation S. *Id.* § 230.251(c)(2). The only exception would be a Regulation S offering directed solely to foreign purchasers outside the United States. Regulation S offerings do not integrate with any registration exemptions. *Id.* § 230.251(c)(2)(iv).

144. Regulation A offerings are not integrated with any prior offerings. *Id.* § 230.251(c)(1) ("Offers and sales made in reliance on this Regulation A will not be integrated with: (1) prior offers or sales of securities . . .").

145. See *supra* text accompanying notes 20-22.

146. See *supra* text accompanying note 28.

147. Section 18 of the 1933 Act specifically preserved state authority to regulate securities offerings made within the state. Securities Act of 1933 § 18(c)(1), 15 U.S.C. § 77r(c)(1) (2012). Since 1933, there has been some limited preemption of state registration provisions for certain types of offerings, but state antifraud provisions continue to apply to all offers and sales regardless of federal registration or federal exemption from registration. See, e.g., *Small Business and the SEC*, U.S. SEC. & EXCHANGE COMMISSION, <http://www.sec.gov/info/smallbus/qasbsec.htm> (last visited Nov. 22, 2014).

148. The 1933 Act antifraud provisions applicable to exempt offerings are section 12(a)(2) and section 17. See *supra* notes 103-05 and accompanying text. Investors also have available Rule 10b-5 remedies under the Securities Exchange Act of 1934 ("1934 Act"), as well as state law remedies. See Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (2012); 17 C.F.R.

The drafters of the 1933 Act recognized that the registration process is not necessary for some types of securities offerings.<sup>149</sup> The 1933 Act thus sought to strike a balance between offerings for which an agency-reviewed registration was necessary and offerings for which the public interest did not require registration. Nowhere among any of the exemptions listed in sections 3 and 4 of the 1933 Act, or the authorization for additional rule-based exemptions, was there any suggestion that issuers could not utilize multiple registration exemptions concurrently or within a relatively short time span. The natural question to ask, therefore, is whether the SEC's integration doctrine is a necessary or appropriate factor for the protection of investors. Given the Commission's own acknowledgement that its integration doctrine imposes a burden on the ability of companies to take advantage of registration exemptions,<sup>150</sup> the integration doctrine can only be justified if it provides a necessary element of investor protection. The doctrine's continued existence must be seriously questioned if it is extraneous to the principal purpose of the 1933 Act while imposing an unquestioned burden upon small business financing.

From the perspective of investor protection, the SEC's "circumvention" justification fails to account for the fact that each registration exemption carries its own distinct set of conditions intended to foster both capital formation and investor protection. Each time an issuer utilizes a registration exemption, it is done in accordance with existing statutory, regulatory, and judicially imposed substantive conditions. Issuers' reliance upon specific exemption conditions raises an interesting question, as section 19(a) of the 1933 Act contains a curious "good faith" provision stating:

No provision of this title imposing any liability shall apply to any act done or omitted in good faith in conformity with any rule or regulation of the Commission, notwithstanding that such rule or regulation may, after such act or omission, be amended or rescinded or be determined by judicial or other authority to be invalid for any reason.<sup>151</sup>

Given the ambiguities inherent in the integration doctrine, it may be plausible to consider whether this statutory provision exculpates issuers who engage in multiple offerings in good faith believing that they are not violating the integration elements.

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§ 240.10b-5 (2014).

149. See *supra* text accompanying notes 30-32 discussing statutory registration exemptions and the delegation of administrative authority to create additional registration exemptions.

150. See *supra* text accompanying note 94.

151. Securities Act of 1933 § 19(a).

It is safe to presume, indeed unfathomable to conclude otherwise, that the terms of each exemption were thoroughly vetted by the SEC relative to the goal of investor protection. The SEC's pejorative "circumvention" characterization of an issuer's decision to engage in two or more offerings ignores the fact that the issuer has acted entirely within the exemption provisions containing specific conditions intended to protect potential investors. Examination of the principal registration exemptions reflects these investor protection elements.

#### A. *The Private Offering Exemptions*

Section 4(a)(2) simply, and without definition, exempts "transactions by an issuer not involving any public offering."<sup>152</sup> It did not take long for the SEC to give content to this enigmatic statutory phrase. A 1935 Interpretive Release focused on the number of offerees and their relationship to the issuer, the number of units offered, the size of the offering and the manner of offering.<sup>153</sup> The exemption was given further, and significant, substantive content in the Supreme Court's 1953 *SEC v. Ralston Purina Co.*<sup>154</sup> decision that emphasized the personal qualifications of, and degree of, disclosure to potential investors.<sup>155</sup> The Court held that in determining the conditions for a registration exemption, "inquiry should be on the need of the offerees for the protections afforded by registration."<sup>156</sup> The issue for the Court was whether the offerees could "fend for themselves" without a registration process.<sup>157</sup> Focus was therefore upon the capacity of the potential purchaser to understand the risks and merits of the offering, including whether the potential investor had access to sufficient information to make an informed decision.<sup>158</sup>

Investor protection elements are equally evident in Rule 506—the SEC-created regulatory private offering exemption. Prior to the mandate of the JOBS Act, there was only one Rule 506 exemption.<sup>159</sup> Today there

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152. *Id.* § 4(a)(2). This exemption was initially section 4(1) of the 1933 Act, later became section 4(2), and as a result of the JOBS Act, is now set forth in section 4(a)(2). *See supra* note 31.

153. Letter of General Counsel Discussing the Factors to be Considered in Determining the Availability of the Exemption From Registration Provided by the Second Clause of Section 4(1), Securities Act Release No. 285, 1935 WL 27785 (Jan. 24, 1935).

154. 346 U.S. 119 (1953).

155. *Id.* at 124-25.

156. *Id.* at 127.

157. *Id.* at 125.

158. *Id.* at 127 ("The employees here were not shown to have access to the kind of information which registration would disclose.").

159. The JOBS Act mandated that the SEC develop an alternative Rule 506 exemption that allowed general advertising and solicitation if all of the purchasers are accredited investors.

are two: Rule 506(b) and Rule 506(c). The initial Rule 506 explicitly adopted the *Ralston Purina* requirement that investors be able to fend for themselves. As reflected in Rule 506(b), each purchaser must have “such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment.”<sup>160</sup> Excluded from this so-called “sophistication requirement” is a set of purchasers defined as “accredited investors,” who are presumed by reason of their financial capacities or particular relationship to the issuer to possess the requisite knowledge and experience to be qualified purchasers.<sup>161</sup> In addition to the personal qualification provisions: non-accredited investors, of which the issuer must reasonably believe that there are no more than thirty-five,<sup>162</sup> are required to receive specific disclosures described in Rule 502(b);<sup>163</sup> securities purchased in any Rule 506 offering are deemed “restricted,” meaning that they cannot be readily resold except under prescribed conditions;<sup>164</sup> and all purchasers are entitled to the protections of anti-fraud provisions.<sup>165</sup> Moreover, Rule 506(d) prohibits the use of the exemption if the issuer, its predecessors and affiliated issuers, or any of its directors, certain officers, promoters, twenty percent beneficial owners, or specified other persons, are subject to a “disqualifying

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Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 201(a)(1), 126 Stat. 306, 313 (2012).

160. 17 C.F.R. § 230.506(b)(2)(ii) (2014). It is sufficient if the issuer has a reasonable belief that the purchaser possesses such qualifications. *See id.* A potential investor lacking such qualifications might nevertheless become a purchaser if he or she, together with his or her purchaser representative, possesses such qualifications. *See id.*

161. *Id.* § 230.501(a). The accredited investor concept was initially created for the statutory section 4(5) exemption created in 1980 for offerings limited to accredited investors. A definition of accredited investors was added as section 2(a)(15) of the 1933 Act. Securities Act of 1933 § 2(a)(15), 15 U.S.C. § 77b(a)(15) (2012); Small Business Investment Incentive Act of 1980, Pub. L. No. 96-477, § 603, 94 Stat. 2275, 2294. The SEC then incorporated the statutory definition of accredited investor into Regulation D on the basis that “certain purchasers would be presumed to meet the purchase qualifications, thereby eliminating the need for subjective judgments by the issuer about the suitability of such investors.” Proposed Revision of Certain Exemptions from the Registration Provisions of the Securities Act of 1933 for Transactions Involving Limited Offers and Sales, Securities Act Release No. 6339, 23 SEC Docket 446 (Aug. 7, 1981).

162. 17 C.F.R. § 230.506(b)(2)(i).

163. *Id.* § 230.502(b). The extent of the disclosure varies depending on the total amount of the issuer’s offering and whether the issuer is a 1934 Act reporting company. *See id.*

164. *Id.* § 230.502(d). Rule 144 imposes minimum holding periods for restricted securities to assure, in part, that such securities are not quickly transferred into the hands of persons who may not have been qualified initial purchasers. *Id.* § 230.144(d).

165. The principal enforcement actions in the event of a material disclosure problem would be an SEC action under section 17 of the 1933 Act and either administrative or private actions under Rule 10b-5 of the 1934 Act. *See* Securities Act of 1933 § 17; 17 C.F.R. § 240.10b-5 (2014). Issuers are also subject to potential criminal prosecutions under both the 1933 Act and 1934 Act, as well as state law statutory and common law sanctions.

event.”<sup>166</sup> These events are defined to include criminal convictions in connection with the purchase or sale of a security and other specified crimes, certain court injunctions, SEC and other specified agency orders, and other enumerated events.<sup>167</sup>

The substantial investor protection measures within the statutory and regulatory private offering exemptions leave neither room nor need for an integration requirement. The integration doctrine does not fill any gap in investor protection elements. The doctrine simply melds two or more offerings into one. But for what substantive end if each of the offerings has satisfied all investor protection conditions imposed by the particular exemptions?

### B. The Regulation A Exemption

From an investor protection perspective, the integration doctrine fares no better when considering the Regulation A exemption. Regulation A requirements include issuer eligibility, disclosure to potential investors, timing of offers and sales, amounts to be offered, disqualifications for prior misdeeds by the issuer, its affiliates, or underwriters, and limitations on pre-offering solicitations.<sup>168</sup> In contrast to all other exemptions, the Regulation A disclosure document is reviewed in advance by the SEC.<sup>169</sup> The Regulation A exemption is as near to a registered offering as an issuer can get.<sup>170</sup> Yet, the SEC applies the integration doctrine to post-Regulation A offerings. If an issuer engages in a Regulation A offering followed two months later by a Rule 506(b) offering, the two offerings may be integrated under the SEC’s

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166. 17 C.F.R. § 230.506(d).

167. *Id.*

168. *See id.* §§ 230.251(a)–(b), .251(d), .252, .254, .262. In March 2015, the SEC divided Regulation A into two distinct exemptions: Tier 1 for offers up to \$20 million; and Tier 2 for offers up to \$50 million. *See supra* note 39. If securities sold in a Tier 2 offering are not to be listed on a national securities exchange, all purchasers must either be accredited investors or be subject to certain limitations on their investments. Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), Securities Act Release No. 9741, Exchange Act Release No. 74,578, Trust Indenture Act Release No. 2501, 80 Fed. Reg. 21,806, 21,807-09 (Apr. 20, 2015).

169. 17 C.F.R. § 230.252.

170. It should also be noted that most states do not have a registration exemption that ties into Regulation A. Tier 2 Regulation A offerings are exempt from state registration provisions. Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. at 21,861-62; *Amendments to Regulation A: A Small Entity Compliance Guide*, U.S. SEC. & EXCHANGE COMMISSION, <http://www.sec.gov/info/smallbus/secg/regulation-a-amendments-secg.shtml#7> (last visited Nov. 22, 2015). If the issuer is planning a Tier 1 Regulation offering up to \$20 million with a broad marketing effort, the issuer will need to register the offering in every state where registration is required, thus providing to prospective purchasers a full disclosure document as well as subjecting the issuer to state review and state-based sanctions. *Amendments to Regulation A: A Small Entity Compliance Guide, supra*.

five-factor test, resulting in the loss of exemption for both offerings.<sup>171</sup> In both cases, the investors were fully protected by the terms of the specific exemption under which they made their purchases. The integration doctrine added nothing to investor protection. The doctrine would, however, if applied, invalidate two otherwise perfectly sound capital-raising efforts, each following prescribed investor protection provisions.

### C. *The Rule 504 and Rule 505 Exemptions*

It is equally difficult to perceive how the integration doctrine adds any element of investor protection for either the Rule 504 or the Rule 505 Regulation D exemptions. Rule 504 is a fairly open-ended exemption with neither disclosure nor purchaser qualification conditions.<sup>172</sup> However, the issuer cannot engage in general advertising and solicitation, which is a major hurdle for small businesses, unless the offering is registered under a state registration provision or is sold exclusively to accredited investors under state accredited investor exemptions.<sup>173</sup> Rule 504 also has an aggregation provision that limits the amount raised under that exemption within a twelve-month period.<sup>174</sup> And, although Rule 504 does not itself have any mandatory disclosure requirement, if there are any material misstatements or omissions in any offering materials or statements, investors have remedies readily available under federal and state antifraud provisions.<sup>175</sup> Thus, although Rule 504 has the least technical conditions of all exemptions, it would challenge credibility to conclude that the SEC deliberately set out to create an exemption that did not adequately protect investors. The relatively low monetary ceiling, the regulatory force of state law, and the ever-present potential application of civil, administrative, or even criminal sanctions for disclosure failures combine to provide substantial investor protection elements. The Rule 505 exemption goes even further than Rule 504, with mandated disclosures to non-accredited investors,<sup>176</sup>

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171. When combined, the two offerings will not be able to satisfy any exemption. The Regulation A offering involved general advertising, forbidden for Rule 506(b), and the Rule 506(b) offering was effected without any SEC filing, thus eliminating Regulation A as a possibility.

172. Rule 504 allows offerings up to \$1 million. 17 C.F.R. § 230.504. *But see* Securities Act Release No. 9973, 80 Fed. Reg. 69,786, 69,832 (Nov. 10, 2015) (proposing the elevation of the Rule 504 capital ceiling to \$5 million). Rule 504 has no purchaser qualifications nor mandated disclosure requirements. 17 C.F.R. § 230.504.

173. *Id.* § 230.504(b)(1).

174. *Id.* § 230.504(b)(2). For the text of the aggregation provision, see *infra* note 192.

175. Rule 504 is regarded as a public offering, and therefore, section 12(a)(2) remedies are available to purchasers, as well the ability to make claims under Rule 10b-5.

176. 17 C.F.R. § 230.505(b)(1) (incorporating the disclosure requirements of Rule 502(b)).



a limit on the number of non-accredited investors,<sup>177</sup> “bad actor” disqualification, and prohibitions against general advertising and solicitation<sup>178</sup> that apply regardless of any state registrations.

#### *D. The Intrastate Offering Exemptions*

The 1933 Act left the regulation of intrastate offerings to the states. The SEC so noted in a 1937 Interpretive Release stating that an “[e]xemption under Section 3(a)(11), if in fact available, removes the securities from the operation of all provisions of the Act except those of Sections 12(2) and 17.”<sup>179</sup> Despite the hands-off admission, the SEC nevertheless imposes its integration doctrine on section 3(a)(11) offerings.<sup>180</sup> The initial basis for imposing the doctrine is the reference to “part of an issue” in the 1933 Act’s exemption provision.<sup>181</sup> This semantic reed suffers from major flaws. First, the “part of an issue” phrase is not found directly or analogously in any other registration exemption or in the delegation of authority to the SEC to create additional exemptions. It would be strange to conclude that the 1933 Act intended to create an integration concept for the intrastate exemption, but not for any other exemption. If the framers of the 1933 Act had intended to limit the availability of exemptions under an integration concept, it would not have been difficult to draft appropriate limiting language. Secondly, the “part of an issue” phrase is subject to alternative interpretations at least as plausible, and perhaps more so, than the SEC’s position that looks at prior or subsequent offerings. The 1933 Act’s key

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177. *Id.* § 230.505(b)(2)(ii) (limiting the offering to no more than thirty-five non-accredited investors).

178. *Id.* § 230.505(b)(1)–(2)(iii) (importing the “bad actor” provisions of Rule 262 applicable to Regulation A offerings, and incorporating the prohibition against general advertising and solicitation of Rule 502(c)).

179. Letter of General Counsel Discussing Nature of the Exemption from Registration Provided by Section 3(a)(11), Securities Act Release No. 1459, 1937 WL 29095 (May 29, 1937). Sections 12(2) and 17 are antifraud provisions applicable to potential disclosure violations. *See* Securities Act of 1933 §§ 12(a)(2), 17, 15 U.S.C. §§ 77l(a)(2), 77q (2012).

180. 17 C.F.R. § 230.251(c). Curiously, integration only applies to post-, not pre-Regulation A offerings. *See id.*

181. Securities Act of 1933 § 3(a)(11) (“Any security which is a part of an issue offered and sold only to persons resident within a single State or Territory . . .”). In its December 1961 Release, the Commission cited its prior *Unity Gold Corp.* decision, *see supra* note 79, indicating that “[w]hether an offering is ‘a part of an issue’, that is, whether it is an integrated part of an offering previously made or proposed to be made, is a question of fact and depends essentially upon whether the offerings are a related part of a plan or program.” Section 3(a)(11) Exemption for Local Offerings, Securities Act Release No. 4434, 1961 WL 61651, at \*1 (Dec. 6, 1961).

term “issue” is not defined. It is entirely plausible to consider the term “issue” to refer to the particular, identified set of securities being offered for sale under the intrastate exemption. Within that group of securities, no offers or sales may be made to any non-residents. This reading is consistent with the first interpretative question to come under section 3(a)(11)—namely, whether an issuer undertaking a proposed registered offering could sell some of the soon-to-be registered shares under the intrastate exemption until the registration became effective.<sup>182</sup> The negative answer was fundamentally consistent with the “issue” concept, as the same securities that were being registered were also proposed to be sold in the intrastate offering.

When one looks at the fundamental question of investor protection, section 3(a)(11) offerings are subject to state registration requirements when there are broad-scale marketing efforts.<sup>183</sup> If the offerings are not state registered, state registration exemptions generally contain investor protection measures such as maximum numbers of investors, limiting marketing constraints, and restrictions on commissions to sales personnel.<sup>184</sup> With regard to the SEC’s own Rule 147, one need go no further than the Commission’s own statement that “adoption of the rule . . . is in the public interest, since it will be consistent with the protection of investors.”<sup>185</sup>

#### *E. Integration as an Unnecessary and Potentially Harmful Doctrine*

If, as appears, each registration exemption has its own set of adequate investor protection elements, there is no policy justification for denying the validity of one offering simply because it could be deemed on an abstract, ambiguous basis to be “part of” or related to another offering. The primary goal of investor protection having been met, the integration doctrine adds nothing.<sup>186</sup> Adding nothing would be a benign

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182. See *supra* text accompanying notes 78-80.

183. See UNIF. SEC. ACT §§ 202, 301 (NAT’L CONFERENCE OF COMM’RS ON UNIF. STATE LAWS 2005).

184. State registration exemptions tend to be very limited in terms of number of purchasers and restraints on marketing. See *id.* § 202(14).

185. Notice of Adoption of Rule 147 Under the Securities Act of 1933—“Part of an Issue,” “Person Resident,” and “Doing Business Within” for Purposes of Section 3(a)(11) of that Act, Securities Act Release No. 5450, 3 SEC Docket 349, at \*1 (Jan. 7, 1974).

186. It may be argued that by forcing issuers to engage in a registered offering, the integration doctrine allows investors to sue for disclosure violations under section 11 of the 1933 Act—a provision that applies only to registered offerings and allows for no defense by the issuer. Disclosure violations in exempt offerings will generally need to be addressed in civil actions under Rule 10b-5, which allows issuers a scienter defense. See STUART R. COHN, SECURITIES COUNSELING FOR SMALL AND EMERGING COMPANIES chs. 19-21 (2015). Thus, it could be argued, registration creates a greater potential benefit for investors because of the easier ability to recover if

effect were it not for the clear adverse impact of the doctrine on capital financing.

Moreover, the integration doctrine may be counter-productive to the goal of investor protection. By creating impediments to capital formation, the integration doctrine may deny to companies the capacity to raise capital that may be needed to strengthen the value of investments held by existing shareholders. If the integration doctrine inhibits or delays a company's financing capacity, existing shareholders, as well as creditors and employees, may suffer the economic consequences. The formalistic integration doctrine is more than simply a hindrance—it is antagonistic to the financial needs of smaller companies and those who rely upon their economic capacities.<sup>187</sup>

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there are disclosure violations. The argument, however, is flawed for several reasons. One is that small businesses concerned about the potential application of the integration doctrine are very unlikely to choose registration as an alternative, as such companies do not have the capacity to engage in registered offerings. Secondly, purchasers in exempt offerings other than private offerings can utilize section 12(a)(2) of the 1933 Act to bring actions based on disclosure violations, and it is a provision that allows the issuer a due diligence defense, even though it is quite difficult for issuers to defend disclosure violations on such grounds. *See id.* Finally, purchasers in all exempt offerings have the full panoply of state law remedies available, both statutory and common law. Many states have broader provisions allowing for investor actions than exist at the federal level. *See id.*

187. Elimination of the integration doctrine as applied to federal registration exemptions will not affect state laws that have similar integration provisions. *See, e.g.,* FLA. STAT. ANN. § 516.061(c) (West 2007). The Official Commentary to the 2002 Uniform Securities Act specifically adopts the federal integration doctrine for the limited offering exemption set forth in its section 202(14). UNIF. SEC. ACT cmt. 15 (NAT'L CONFERENCE OF COMM'RS ON UNIF. STATE LAWS 2005). Some states have incorporated integration provisions into their statutes. *See, e.g.,* FLA. STAT. ANN. § 516.061(c). Although such provisions would remain regardless of SEC action, elimination of the federal doctrine would nevertheless have a material impact. By far the most commonly used federal exemption is Rule 506, which preempts state registration and exemption provisions. Based on an SEC sponsored survey for the years 2009-2012, Rule 506 offerings constituted ninety-nine percent of all amounts sold under Regulation D, of which more than two-thirds of those offerings were for amounts that could have utilized Rule 504 or Rule 505 exemptions. VLADIMIR IVANOV & SCOTT BAUGUESS, U.S. SEC. & EXCH. COMM'N, CAPITAL RAISING IN THE U.S.: AN ANALYSIS OF UNREGISTERED OFFERINGS USING THE REGULATION D EXEMPTION, 2009-2012, AN UPDATE OF THE FEBRUARY 2012 STUDY 3 (2013). During the same 2009-2012 period, there were only nineteen Regulation A offerings, as compared to approximately 27,500 Regulation D offerings up to \$5 million (the Regulation A ceiling.) Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, Securities Act Release No. 9497, Exchange Act Release No. 71,120, Trust Indenture Act Release No. 2493, 79 Fed. Reg. 3926, 3928 (Jan. 23, 2014). If, and when, the SEC adopts rules for the enlarged Regulation A exemption and the crowdfunding exemption, those exemptions will also preempt state registration and exemption laws. State integration provisions will only be applicable to a relatively small number of offerings. In non-preempted instances, such as intrastate offerings and Rule 504 offerings, state law will usually require registration, a costly and tedious process, which companies are not likely to undertake without assuring that they are raising sufficient capital to meet foreseeable and contingent expenses.

## VI. LIMITED RETENTION OF THE INTEGRATION DOCTRINE FOR NUMERICALLY BASED EXEMPTIONS

The argument for elimination of the integration doctrine presumes that most issuers that engage in multiple offerings are acting in good faith to meet capital needs. There is, however, one instance where the integration doctrine may be justified—namely where the exemption specifically limits the number of purchasers. Rules 505 and 506(b) are the only two exemptions with such limits, both of which require that the issuer reasonably believe that there are not more than thirty-five non-accredited investors.<sup>188</sup> One can imagine an issuer conducting a Rule 505 or Rule 506(b) offering that reaches the maximum thirty-five non-accredited purchasers and then immediately embarking on another nominally different Rule 505 or Rule 506(b) offering to additional non-accredited potential investors. If such multiple offerings occur one after the other, or within a relatively short time frame, the offerings would effectively emasculate the numerical limitations. Such tactics, if permitted, would render the numerical limitations moot.<sup>189</sup> If numerical limitations are to retain any force and effect, the integration doctrine will need to apply to follow-on offerings for numerically limited exemptions that simply parrot the initial offering. The possibility of follow-on Rule 506 offerings that result in sales to numerous non-accredited investors was cited by the Commission as a reason for not reducing the integration safe harbor to thirty days as recommended by its Advisory Committee, and instead the Commission proposed, but never adopted, a reduction of the safe harbor time frame to ninety days.<sup>190</sup> Adoption of that reduced time frame would be reasonable and appropriate for numerically based exemptions. In all other instances, the integration doctrine should be eliminated.

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188. 17 C.F.R. §§ 230.505(b)(2)(ii), .506(b)(2)(i) (2014).

189. One may appropriately question the Rule 505 and Rule 506(b) numerical limitations. The need for such a limitation seems particularly inappropriate for Rule 506(b), as all non-accredited purchasers are by definition sophisticated or represented by qualified purchaser representatives. It seems quite arbitrary to limit such purchasers in any numerical way. Although Rule 505 purchasers are not required to have the same purchaser qualifications as exist in Rule 506, the numerical limitation in Rule 505 may also be seriously questioned. There are no numerical limitations for either intrastate or Rule 504 offerings, which, unlike Rule 505, do not have any disclosure requirements as a condition of the exemption. What purpose is served by limiting Rule 505 non-accredited investors to thirty-five? The numerical limitation simply hampers companies in their capital-raising efforts, but adds nothing of substance to investor protection concerns. If the Commission could provide a plausible explanation for why there is a numerical limitation, or why it is not fifty, or one hundred, perhaps the condition could be understood. As is, the numerical condition is simply another unnecessary hindrance to financing efforts by smaller companies, many of whom do not have access to large numbers of accredited investors.

190. *See supra* note 135 and accompanying text.

*A. Exemptions with Monetary Limitations*

Three exemptions from registration have monetary ceilings: Rule 504; Rule 505; and Regulation A.<sup>191</sup> If there is a basis for retaining the integration doctrine for exemptions with numerical limitations, does a similar basis apply to exemptions with monetary ceilings? The answer is clearly no, since all of these exemptions include aggregation conditions. Rule 504 is limited to \$1 million.<sup>192</sup> If a company uses Rule 504 to raise \$1 million, and then immediately starts another \$1 million Rule 504 offering, or any other offering under a section 3(b) exemption, the second offering would run afoul of the Rule 504 aggregation provisions. The aggregation provisions make multiple short-term Rule 504 offerings impossible. Aggregation would not be applicable if a Rule 504 offering was followed by a Rule 506(b) or Rule 506(c) offering, as those rules are not section 3(b) exemptions. However, in light of the investor protection provisions contained in each of the respective exemptions, particularly given the personal qualification provisions in Rule 506(b) and Rule 506(c), there is no viable justification for integrating Rule 504 and Rule 506 offerings. Similarly, a company is very unlikely to engage in multiple short-term Rule 505 offerings. Rule 505 is also subject to aggregation provisions that would limit successive Rule 505 offerings that together exceed \$5 million.<sup>193</sup> If the company thinks that it has the capacity to raise more than \$5 million, it would be much better served by using Rule 506(b) or Rule 506(c), which have no monetary ceilings.

Regulation A also has an aggregation provision that limits the total amount raised under Regulation A offerings within a twelve-month period to \$5 million.<sup>194</sup> One need not apply an integration concept to follow-on Regulation A offerings as aggregation supplies the monetary limit. Follow-on Rule 504 or Rule 505 offerings would run afoul of the aggregation provisions contained within each of those rules. A follow-on Rule 506 offering could result in more than \$5 million being raised within a twelve-month period, but the requirements for both Regulation A and Rule 506 are so substantial, and the investor protection elements so strong, that there is no policy justification for denying a

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191. 17 C.F.R. §§ 230.251(b), .504(b)(2), .505(b)(2)(i).

192. *Id.* § 230.504(b)(2) (“The aggregate offering price for an offering of securities under this [Rule 504] . . . shall not exceed \$1,000,000, less the aggregate offering price for all securities sold within the twelve months before the start of and during the offering of securities under this [Rule 504], in reliance on any exemption under section 3(b), or in violation of section 5(a) of the Securities Act.”).

193. *Id.* § 230.505(b)(2)(i).

194. *Id.* § 230.251(b).

company the ability to raise additional funds in a post-Regulation A private offering regardless of timing or purpose.

### *B. Related Companies*

The integration doctrine has also been applied to related companies with substantial overlapping ownership that engage in concurrent offerings for similar business purposes.<sup>195</sup> This is an atypical situation that hinges principally on the question of the issuer's true identity. If, in fact, the apparently distinct entities have no material separate existence, it is entirely appropriate to determine that the supposedly distinct offerings must be combined within a single exemption. This result is consistent with an ABA report that focused on the economic independence of the issuers.<sup>196</sup>

## VII. CONCLUSION

The integration doctrine might be justifiable if it served a policy goal consistent with the 1933 Act. However, that is not the case. Instead, the doctrine is simply formalistic, inherently ambiguous, inconsistent in application, and contrary to the broadly accepted national goals to foster and promote small business capital formation.<sup>197</sup> No patchwork modification should be undertaken, such as an effort to redefine or clarify the Commission's five-factor test. When issuers engage in multiple offerings within a relatively short period of time, the primary question should be whether such offerings complied with the issuer's chosen exemption.<sup>198</sup> Such an analysis would be consistent with the Supreme Court's admonition that, in determining the conditions for a registration exemption, "inquiry should be on the need . . . for the protections afforded by registration."<sup>199</sup> Every registration exemption contains significant investor protection elements.<sup>200</sup> If the Commission believes otherwise, the proper course is to modify exemption requirements, not to artificially join two or more distinct offerings into

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195. See, e.g., Thomas H. Chambers, SEC No-Action Letter [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,618 (June 28, 1976) (denying a no-action letter for an offering by distinct oil and gas drilling limited partnerships where there was an overlap in general partners and contractual relationships).

196. A.B.A. Subcomm. on P'ships, Trusts and Unincorporated Ass'ns, *supra* note 98, at 1610.

197. See *supra* Part IV.

198. See *supra* Part V.

199. SEC v. Ralston Purina, 346 U.S. 119, 127 (1953).

200. See *supra* Part V.A–D.

one. The Commission should recognize, and if it does not, Congress should mandate, that the integration doctrine should be eliminated for all but the narrowest of circumstances involving numerically based exemptions.